No. 15787

In the

United States Court of Appeals

For the Ninth Circuit

UNDERWRITERS SERVICE, INC., a corporation,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petitioner's Opening Brief

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I.

JURISDICTIONAL STATEMENT

This is a petition to review the decision entered in the above-entitled proceedings by The Tax Court of the United States on May 17, 1957, which ordered and decided that there were deficiencies in the income and excess profits tax of Petitioner for its taxable years 1950, 1951 and 1952 (R. 38). On August 14, 1957, Petitioner filed a petition for review (R. 39-44).

The jurisdiction of The Tax Court of the United States is based upon Section 7442 of the Internal Revenue Code of 1954 (26 U.S.C.A., Section 7442), and the controversy is to be determined under the Internal Revenue Code of 1939, as amended by the Excess Profits Tax Act of 1950.

As Petitioner made its Income and Excess Profits Tax Returns for the calendar years 1950 and 1951 with the Collector of Internal Revenue for the First District of California, at San Francisco, California, and for the calendar year 1952 with the District Director of Internal Revenue, at San Francisco, California, the jurisdiction to review the decision of The Tax Court of the United States is conferred upon this Court by Section 7482 of the Internal Revenue Code of 1954 (26 U.S.C.A., Section 7482).

The Tax Court of the United States filed a written opinion in these proceedings on May 13, 1957 (R. 32-37).

II.

STATEMENT OF THE CASE

A. Questions Involved and Manner in Which Raised.

1. Whether or not the second sentence of Section 435(d)(1) of the Internal Revenue Code of 1939 is applicable to the facts of this case, as hereinafter set forth, and if so, whether the aggregate excess profits tax net income for the twelve months in 1946 is $226,590.62. This question has been raised by The Tax Court of the United States summarily holding, contrary to either the position of the Petitioner or the apparent assumption of the Respondent, that said provision has no application to this case.

2. Whether or not each of the periods for which a separate or consolidated income tax return was filed returning Petitioner's income for the calendar year 1946 constituted a "taxable year" as that term is used in Section 435(d)(1) of the Internal Revenue Code of 1939, as amended, and as said term is defined in Section 48(a) of the 1939 Code. This question has been raised by the Petitioner, and by the failure of The Tax Court of the United States to so hold.

3. Whether or not the excess profits tax net income of Petitioner for each month during the calendar year 1946,

by the application of said Section 435(d)(1), is to be computed by dividing the excess profits tax net income for each of its taxable years by the number of full calendar months in each such period and assigning the resulting amount to each full month and each fractional month in each such period. This question has been raised in the same manner as that mentioned at paragraph 2 hereinabove.

4. Whether or not The Tax Court of the United States properly ignored the principles of statutory construction applicable to tax statutes, which principles require and support the computations of the excess profits net income made by petitioner for the twelve months of 1946. This question has been raised by The Tax Court of the United States holding contrary to such principles of statutory construction that the computations of Petitioner were unreasonable and without authority in law.

B. Statement of the Facts.

This case arose out of a controversy between the Petitioner and Respondent with respect to the computation of the Petitioner's excess profits tax credit under the income method for the calendar years 1950 through 1952. More specifically, it involves the proper method of computing the excess profits net income of Petitioner for each of the months in the calendar year 1946, one of the base period years to be used in the determination of such credit. It is the contention of the Petitioner that its excess profits net income for each of the months in 1946 is to be computed in accordance with Section 435(d)(1) of the Internal Revenue Code of 1939, as amended by the Excess Profits Act of 1950, and that such section cannot be ignored in making this computation.

Apparently assuming that Section 435(d)(1) was to be applied, although not in accordance with the specific lan-

guage found therein, Respondent asserted deficiencies in the Petitioner's excess profits taxes for the calendar years 1950 through 1952, which, as set forth in the Respondent's statutory notice to Petitioner, were as follows:

1950	$1,043.52
1951	9,791.02
1952	7,089.25

The Tax Court of the United States concluded that the Commissioner's determination, as set forth in said statutory notice, was correct. (R. 35).

In an amended answer filed by Respondent in the proceedings before The Tax Court of the United States (R. 21-24), Respondent asserted increased deficiencies in the Petitioner's excess profits taxes for the calendar years 1950 through 1952 to the following amounts:

1950	$ 1,467.62
1951	10,622.42
1952	7,910.76

The increased deficiencies asserted by the Respondent were rejected as incorrect by The Tax Court of the United States (R. 37).

The facts relating to this controversy were stipulated by a written stipulation (R. 24-27), and by two exhibits filed as part of an oral stipulation (R. 30-31) at the time of the hearing on this matter before The Tax Court on August 27, 1956, and were so found by The Tax Court. The situation thereby presented is as follows:

The Petitioner, a California corporation duly incorporated on May 19, 1937 and having its principal office in San Francisco, California (R. 24), became a wholly-owned subsidiary of Henry J. Kaiser Company on September 20, 1946, and continued as such until December 18, 1946. On

that day, Henry J. Kaiser Company ceased to own 95% of the voting stock of Petitioner (R. 25).

Knowing that an affiliated group of corporations, of which Henry J. Kaiser Company was the common parent and the Petitioner was a member, would file a consolidated income tax return for the taxable year of Henry J. Kaiser Company ending June 30, 1947, the Petitioner's representative, in a letter dated April 10, 1947, requested a ruling from the Bureau of Internal Revenue with respect to two problems created by such proposed filing (R. 27-29). In response to this request, the Bureau of Internal Revenue issued a ruling, dated April 18, 1947, that, with respect to the first such problem, the Petitioner would not be required to change its accounting period to conform to that of Henry J. Kaiser Company unless the Petitioner filed or was required to file a consolidated return with the aforementioned affiliated group for the subsequent taxable year (R. 18).

The other problem upon which a ruling was requested by Petitioner concerned the proper method of reporting the Petitioner's income for the portion of the calendar year 1946 during which Petitioner was not a member of the aforementioned affiliated group (R. 29). In answer to this problem, the Bureau of Internal Revenue ruled, in the same letter dated April 18, 1947, that the Petitioner would be required to file a separate income tax return for each of the two periods in 1946 during which it was not a member of the affiliated group. This ruling was stated as follows:

> "It is held that the foregoing provisions of the regulations require in the case of the facts presented with respect to your corporation that a separate return be filed for each period during the calendar year 1946 in which your corporation was not a member of the affiliated group. Accordingly, one separate income tax return should be filed for the period January 1, 1946, to

> September 20, 1946, and another return should be filed for the period December 19, 1946, to December 31, 1946. Each period of less than 12 months for which either a separate or consolidated return is filed, under the provisions of section 23.13, shall be considered as a taxable year. (Section 23.31(g) of Regulations 104.)" (R. 19).

The income of Petitioner for the period September 21, 1946, through December 18, 1946, was then included in the consolidated income tax return filed by the affiliated group, of which Henry J. Kaiser Company was the common parent, for the fiscal year ended June 30, 1947 (R. 26). The Petitioner's excess profits net income for this period was $78,-512.90, of which $79,012.90 was included in that consolidated return (R. 26-27). (A $500 charitable deduction was not allowable on the consolidated return.)

Pursuant to the above-mentioned ruling of the Bureau of Internal Revenue, the Petitioner filed a separate income tax return for the period January 1, 1946 through September 20, 1946, and one for the period December 19, 1946 through December 31, 1946. The excess profits net income of the Petitioner returned for the first such period was $68,174.60, and it sustained a net operating loss in the amount of $7,131.61 for the second such period. The Petitioner also filed a claim for refund of a portion of the income taxes paid by it for the period January 1, 1946 through September 20, 1946 based on the carry-back of such net operating loss, which claim was allowed (R. 26).

Because of having three taxable periods in the calendar year 1946 for which income tax returns were required to be filed, the Petitioner deemed it obligatory to apply the language of Section 435(d)(1) of the Internal Revenue Code of 1939 in computing its excess profits tax credit for the years 1950 through 1952, and particularly to consider each of said three taxable periods as a "taxable year" under said

Section 435(d)(1). Accordingly, the Petitioner computed an aggregate excess profits tax net income of $226,590.62 for the twelve months in the base period year of 1946, as shown in the schedule filed as part of the oral stipulation before The Tax Court (R. 31) and set forth as follows:

1	2	3	4	5	6
Taxable year	Excess profits net income for taxable year	Number of full months in taxable year	Excess profits net income for each month or part of a month	Number of full and part months in period	Column 4 times Column 5
1/1/46 to 9/20/46	$68,174.60	8	$ 8,521.83	9	$ 76,696.43
9/21/46 to 12/18/46	78,512.90	2	39,256.45	4	157,025.80
12/18/46 to 12/31/46	(7,131.61)	0	(7,131.61)	1	(7,131.61)
Total excess profits net income for the 12 months of the year 1946					$226,590.62

(EX. 5-E)

This aggregate amount was computed by dividing the income for each of the three taxable periods mentioned above by the number of full months in each such period and then assigning the resulting amount to each full month and each fractional month within such period. These amounts so assigned were then aggregated to determine the excess profits tax net income for each of the months in such calendar year.

The Respondent, however, refused to accept this obvious interpretation of the language of Section 435(d)(1), and, instead, determined that the Petitioner's excess profits tax net income for the twelve months in 1946 could not exceed the amount of the actual excess profits net income of $139,791.09 (minus a statutory loss adjustment of $3.33, or $139,787.76) earned and credited to surplus by the Petitioner (R. 27).

The effect of this determination by the Respondent led to the deficiencies asserted against the Petitioner for the tax years involved in this controversy.

III.

SPECIFICATION OF ERRORS

The Petitioner specifies the following as errors of The Tax Court of the United States upon which it relies on this appeal:

1. Failure to conclude as a matter of law that the Commissioner has incorrectly determined the excess profits net income of Petitioner for the 12 months of 1946;

2. Failure to conclude as a matter of law that the second sentence of Section 435(d)(1) of the Internal Revenue Code of 1939 is applicable to the facts as stipulated in this case;

3. Failure to conclude as a matter of law that each of the periods for which a separate or consolidated income tax return was filed returning Petitioner's income for the calendar year 1946 is a taxable year within the definition of the term "taxable year" in Section 48(a) of the Internal Revenue Code of 1939, the Respondent's Regulations issued pursuant thereto and Respondent's Rulings pertaining thereto;

4. Failure to conclude as a matter of law that, according to the clear terms of Section 435(d)(1) of the Internal Revenue Code of 1939, the excess profits tax net income of Petitioner for each month during the calendar year 1946 is arrived at by dividing the excess profits tax net income for each of the taxable years by the number of full calendar months in such period;

5. Failure to conclude as a matter of law that Petitioner correctly computed its excess profits net income under Section 435(d)(1) of the Internal Revenue Code of 1939 for the 12 months of 1946 in the amount of $226,590.62;

6. Failure to conclude as a matter of law that the principles of statutory construction with respect to tax statutes compel it to render a decree in favor of Petitioner and against Respondent.

IV.

ARGUMENT

A. Analysis of the Controversy and General Discussion.

As indicated by the discussion under "Statement of the Case", the facts involved in this controversy were submitted to The Tax Court of the United States on stipulations of fact and there is therefore no apparent disagreement between the parties in this matter with respect thereto. In addition, there is no question that, for the computation of the Petitioner's excess profits tax credit based on income for the tax years here involved, the Petitioner's base period consists of the four calendar years 1946 through 1949, inclusive. There is also no dispute between the parties with respect to the excess profits net income of the Petitioner for the base period years 1947 through 1949, nor is there any dispute with respect to the amount of the Petitioner's excess profits net income for the year 1946 as set forth in the statutory notice, provided the theory of the Respondent, under which this figure was computed, is upheld by this Court.

The sole issue in this case revolves around Section 435(d)(1) of the Internal Revenue Code of 1939. Specifically, the question is whether or not this section is to be applied in making the computation to determine the excess profits net income of Petitioner for the twelve months in the calendar year 1946 and, if so, how this computation is to be made. The sole issue is purely and simply a matter of law, upon which there is no decision of any court.

Taking the position that not only can Section 435(d)(1) be applied, but that it must be applied, in the circumstances of this case, the Petitioner, in accordance with the clear terms of this section, computed its excess profits net income for the twelve months in 1946 in the amount of $226,590.62. The Commissioner insisted, however, on reading into this

section terms which are *not* found therein and reading out of it terms which *are* found therein. He then determined that the amount of actual excess profits net income earned in 1946 by the Petitioner in the amount of $139,791.09 must also be the figure used in computing the Petitioner's excess profits tax credit based on income for the years 1950 through 1952. While the Respondent at least attempted to apply Section 435(d)(1) in making his determination, although doing great violence to the terms thereof, The Tax Court of the United States arbitrarily, and without any legal basis therefor, held that the mathematical formula set out in the second sentence of this section had no application to this case.

Apparently these positions have been taken by both the Respondent and The Tax Court of the United States because the unusual situation of the Petitioner in having three taxable years during the calendar year 1946 has led to the unusual situation of the Petitioner having a greater excess profits tax credit under Section 435(d)(1) than it would have had if its actual income for the twelve months of the calendar year 1946 had been used. It would seem that unusual situations leading to what might perhaps be called an unexpected result under tax statutes, being no novelty, should not result in controversies of this nature. As will be demonstrated in the following discussion of specific aspects of this controversy, this case is not so unusual, nor is the language of Section 435(d)(1) so ambiguous, that the Respondent and The Tax Court of the United States should be sustained in their refusal to apply and give effect to Section 435(d)(1) and to long established principles of taxation.

B. The Applicability of Section 435(d)(1) of the Internal Revenue Code of 1939.

Section 435 of the Internal Revenue Code of 1939, as amended by the Excess Profits Tax Act of 1950, reads, in part, as follows:

"Sec. 435. Excess Profits Credit—Based on Income.

"(a) Amount of Excess Profits Credit.—The excess profits credit for any taxable year, computed under this section, shall be—

"(1) Domestic Corporations.—In the case of a domestic corporation the sum of—

"(A) 83 per centum of the average net income.

"(B) If the average base period net income of the taxpayer is the amount determined under subsection (d) of this section or under section 442,12 per centum of the amount of the base period capital addition, computed under subsection (f), and

"(C) 12 per centum of the net capital addition (as defined in subsection (g)(1) for the taxable year,

minus 12 percentum of the net capital reduction (as defined in subsection (g)(2) for the taxable year.

"(b) Base Period.—As used in this subchapter the term 'base period' means the period beginning January 1, 1946, and ending December 31, 1949, except that in the case of a taxpayer whose first taxable year under this subchapter was preceded by a taxable year which ended after December 31, 1949, and before April 1, 1950, and which began before January 1, 1950, the term 'base period' means the period of 48 consecutive months ending with the close of such preceding taxable year.

* * * * * * *

"(d) Average Base Period Net Income.—General Average.—The average base period net income determined under this subsection shall be determined as follows:

"(1) By computing the excess profits net income for each month in the base period. The excess profits net income for any month during any part of which

the taxpayer was in existence shall be the excess profits net income for the taxable year in which such month falls divided by the number of full calendar months in such year, but in no case shall the excess profits net income for any month be less than zero. The excess profits net income for any month during no part of which the taxpayer was in existence shall be zero."

* * * * * * *

The provisions of the above section with respect to the computation of a taxpayer's excess profits credit are invoked by Section 434 of the Internal Revenue Code of 1939, which reads as follows:

"Sec. 434. Excess Profits Credit—Allowance.

"(a) Domestic Corporations.—In the case of a domestic corporation, the excess profits credit for any taxable year shall be an amount computed under section 435 or section 436, whichever amount results in the lesser tax under this subchapter for the taxable year for which the tax under this subchapter is being computed."

Until The Tax Court of the United States handed down its decision in this case on May 17, 1957, the Petitioner assumed (and is still convinced) that Section 435(d)(1) must be applied to the circumstances found in this case, since the clear and specific terms of that section provide the only method for computing the taxpayer's average base period net income for each month during that period. It was also apparent that the Respondent assumed this section was applicable, since, in his argument before The Tax Court, he contended, not that such section was inapplicable, but simply that it was to be applied in a manner other than that used by the Petitioner.

The Tax Court, however, decided that, no matter what the language of Section 435 might be, it should be ignored.

This, of course, resulted in a new area of conflict being introduced into this matter.

While the Respondent's position heretofore taken ignores all principles of statutory construction, as hereinafter discussed, the holding of The Tax Court that Section 435 does not apply amounts to a pure and simple case of judicial legislation. Apparently deciding that Section 435 *should* not apply, The Tax Court has then proceeded to either write that section out of the Internal Revenue Code for this case, or it has rewritten it in order to sustain such a decision. This is easily demonstrated.

It would seem that it is incontrovertible that Section 435 (d)(1) is to be used, by virtue of its specific language, in the determination of the taxpayer's average base period net income. It would also seem clear that this is to be arrived at by computing excess profits net income for each month, and each fraction of a month, in each taxable year in the base period. This is, of course, different than the method used under the Excess Profits Tax Act of World War II, which provided for the computation of excess profits net income on an average *year* rather than months. This latter Act also provided specifically for taxable years of less than twelve months.

It is also quite patent that Congress clearly intended, in enacting Section 435(d)(1), that corporations might, under some circumstances, have a larger excess profits net income than actual income. For example, a corporation organized on November 30, and adopting a calendar year, would have an excess profits tax credit twice as large as its actual income for that period, since the income earned in the month of December would also be attributed to November. The principle is equally applicable here.

Assuming, as we must, that Section 435(d)(1) must be applied to determine a taxpayer's excess profits net income for each month in the base period, how is that income to be

computed? The second sentence of that section provides the answer for all cases where the taxpayer, in a taxable year, had a month during which it was in existence *either* in whole *or* in part. The statutory language is "*any* month during *any* part of which the taxpayer was in existence." (Emphasis added.) The third sentence answers the question as to the amount of income to be attributed to any month *no* part of which the taxpayer was in existence, which amount is zero. It is as simple as that, with each possibility clearly provided for in the statutory formula. One will look in vain to find any language inferring that, under a particular set of circumstances, the formula is to be ignored.

The Tax Court, however, has completely ignored the above provisions of Section 435(d)(1), contending that such provisions are not applicable here because it feels that the purpose of that section was to cover some other situation not spelled out in the language thereof. The Tax Court, without citing any support, assumes, arbitrarily and incorrectly, that the purpose of that second sentence "is to give some slight relief in a situation where the taxpayer was in existence for only a part of the beginning month of one of its taxable years" (R. 36). It then decides that the Petitioner is not within this arbitrarily assumed purpose because it had no months during 1946 in which it was in fact in existence for a part only, although the language of the statute is not limited to that situation.

Be that as it may, The Tax Court is obligated to construe a statute as it is written, it is not to read it as it feels it should be written, and it is not to ignore it should it feel it should not be applied. If the purpose of Section 435(d)(1) were as contended by The Tax Court, Congress could quite easily have stated such purpose in the following language, which is the apparent language The Tax Court has in this case "judicially legislated":

"(d) Average Base Period Net Income—General Average.—The average base period net income determined under this sub-section shall be determined as follows:

"(1) By computing the excess profits net income for each *entire* month in the base period *during which the taxpayer was in existence*. The excess profits net income for any month during *only* (delete *any*) part of which the taxpayer was in existence shall be the excess profits net income for the taxable year in which such month falls divided by the number of full calendar months in such year, but in no case shall the excess profits net income for any month be less than zero. The excess profits net income for any month during no part of which the taxpayer was in existence shall be zero." (Italicized words added.)

It is submitted that the application of Section 435 cannot be avoided by any such attempt to either ignore its clear language or to read into the existing language such words and phrases as were not enacted by Congress but which The Tax Court feels will bring this section of the Internal Revenue Code within an imagined purpose.

C. Each of the Periods for Which Returns Were Filed by Petitioner During the Calendar Year 1946 Was a "Taxable Year".

As has already been indicated, the basic disagreement between the parties in this matter (at least until the above decision of The Tax Court) concerns the meaning to be given the term "taxable year" as found in Section 435(d)(1). This is the crux of the situation here presented, in view of the three taxable periods of the Petitioner in the calendar year 1946 for which a separate or a consolidated return was filed, and assuming, as we must, that Section 435(d)(1) is to be applied. Since this section refers, not to a calendar year or to an accounting period, but specifically to a "taxable

year", the application of such section is meaningless unless effect is given to this phrase. Thus, a determination that the three taxable periods of the Petitioner in 1946 are taxable years within the meaning of section 435(d)(1) must result in a reversal of The Tax Court.

Looking first to the meaning given the term "taxable year" by the Internal Revenue Code, and the applicable regulations thereunder, there should be no reasonable doubt that each of the periods for which a separate or consolidated return was filed by the Petitioner in 1946 was a "taxable year" as that term is used in section 435 (d)(1) of the 1939 Code. Section 48(a) of the 1939 Code is as follows:

> "(a) Taxable Year.—'Taxable year' means the calendar year, or the fiscal year ending during such calendar year, upon the basis of which the net income is computed under this Part. *'Taxable year' means, in the case of a return made for a fractional part of a year under the provisions of this chapter or under regulations prescribed by the Commisioner with the approval of the Secretary, the period for which such return is made."* (Emphasis supplied.)

The provisions of the Consolidated Return Regulations 104, in effect for the calendar year 1946, required two separate returns and one consolidated return during the year 1946. Section 23.13(a) of Regs. 104 provides:

> "(a) General Rule.
>
> "Except as hereinafter provided, a consolidated return must include the income of the common parent corporation and of each subsidiary for the entire taxable year of the affiliated group."

Clearly under this provision, the income of Petitioner for the period from September 21, 1946 through December 18, 1946 was required to be included in the consolidated return of Henry J. Kaiser Company. Section 23.13(g) of Regs. 104 provides:

"(g) Separate Returns for Periods Not Included in Consolidated Return.

"If a corporation, during its taxable year (determined without regard to the affiliation), becomes a member of an affiliated group, its income for the portion of such taxable year not included in the consolidated return of such group must be included in a separate return (or, if a member of another affiliated group which makes a consolidated return for such period, then in such consolidated return). If a corporation ceases to be a member of the affiliated group during the taxable year of the group, its income for the period after the time when it ceased to be a member of the group must be included in a separate return (or, if it becomes a member of another affiliated group which makes a consolidated return for such period, then in such consolidated return)."

Clearly under this provision of the Respondent's Regulations, the income of the Petitioner for the period January 1, 1946 through September 20, 1946 was required to be included in a separate return and the Petitioner's income for the period December 19, 1946 through December 31, 1946 was required to be included in a separate return.

Not only does this clearly follow under the provisions of the Internal Revenue Code and the Regulations promulgated thereunder but the Respondent has, based on the very facts involved here, ruled that these returns were required and that each period for which a return was required is a taxable year. In its ruling dated April 18, 1947, the Bureau of Internal Revenue stated as follows:

"It is held that the foregoing provisions of the regulations require in the case of the facts presented with respect to your corporation that a separate return be filed for each period during the calendar year 1946 in which your corporation was not a member of the affiliated group. Accordingly, one separate income

> tax return should be filed for the period January 1, 1946, to September 20, 1946, and another return should be filed for the period December 19, 1946, to December 31, 1946. *Each period of less than 12 months for which either a separate or consolidated return is filed, under the provisions of section 23.13, shall be considered as a taxable year.* (Section 23.31 (g) of Regulations 104.)" (Emphasis supplied.)

As pointed out earlier, no case (prior to the decision of The Tax Court in this matter) has considered the specific question raised by the circumstances of this case. However, a decision in a number of cases has heretofore turned on the meaning of the term "taxable year" as it applies to fractional years, and, nearly without exception, the Commissioner has taken the position that such term means the period for which a return is made. The circumstances of these cases primarily involved the application of the loss carry-forward or carry-back provisions of the Internal Revenue Code.

For example, the case cited by The Tax Court, as tacit support for its holding that Section 435(d)(1) had no application to this case, *Helvering v. Morgan's, Inc.,* 293 U.S. 121 (1934), held, in determining the extent of a loss carry-over, that the Commissioner was wrong in contending that the term "taxable year" meant the period for which a return was made. The important point, however, is that the then equivalent of Section 48 (a) of the 1939 Code read that the term "taxable year" *includes* a return made for a fractional part of a year. The Commissioner was not upheld, because the Supreme Court of the United States determined that the word "includes" was not an interchangeable equivalent with the word "means". This was, of course, corrected in the 1942 Revenue Act, Section 135(d),

which amended this section by striking out the word "includes" and inserting in lieu thereof "means".

It is, therefore, quite obvious that, in spite of the language of the Supreme Court concerning accounting periods and calendar years, its decision would have been different had it been faced with construing the meaning of the term "taxable year" as it now stands.

More in point is the case of *Wishnick-Tumpeer, Inc. v. Commissioner,* 77 F.2d 774 (App. D.C. 1935), cert. den. 296 U.S. 628 (1935). Here the taxpayer corporation was on a calendar year accounting basis and its affiliate was on the basis of a fiscal year ending October 31. Upon the parent changing its accounting period in 1929 from the calendar year to a fiscal year ending June 30, the affiliate had to incude its income for the period from July 1, 1928 to October 31, 1928 in a separate return for its fiscal year ending October 31, 1928, had to include its income for November and December 1928 in a separate return filed for that fractional period, and had to return its income for the period January 1 to June 30, 1929 on a consolidated return filed with its parent for the fiscal year ending June 30, 1929. Thus the affiliate had three taxable periods within a twelve consecutive month period.

The Commissioner ruled that November and December 1928 was a separate "taxable year" and that, as a result, the loss of the affiliate incurred during its fiscal year 1927 could be offset against income allocated to the "taxable year" consisting of the two months of November and December 1928, but not against income for its "taxable year" from January 1 to January 30, 1929. The taxpayer argued that the term "taxable year" did not mean a fraction of a year, but meant a full twelve month period. The Commissioner, however, was upheld by the Circuit Court of Appeals, because a regulation of the Commissioner, not in effect at

the time of the decision in *Helvering v. Morgan's, Inc., supra,* provided that "any period of less than twelve months for which either a separate or consolidated return was filed shall be a taxable year."

Finally, it should be noted that this construction of the term "taxable year" has already operated to the detriment of the Petitioner by reason of the circumstances in this case. During its taxable year December 19, 1946 through December 31, 1946, Petitioner suffered a loss in the amount of $7,131.61. Pursuant to the provisions of Section 122 of the Internal Revenue Code of 1939, this net operating loss was a net operating loss carry-back first to the second preceding year. Because the taxable period September 21, 1946 through December 18, 1946 was a taxable year, the second preceding taxable year was the period January 1, 1946 through September 20, 1946. The taxpayer filed a claim for refund based on this carry-back and was refunded taxes based on such claim. The effective tax rate for the period was 38%. Had the taxable period September 21, 1946 through December 18, 1946 not been a taxable year, the loss would have been carried back to the calendar year 1945, an excess profits tax year, and the recovery would have been at a tax rate of 95%. Having suffered the detriments of the application of these principles of law, Petitioner is most certainly entitled to the benefits thereof.

By reason of the above discussion, the conclusion seems inescapable that each of the three periods covered by income tax returns in 1946 of the Petitioner were taxable years as that term is used in Section 435(d)(1) of the 1939 Code. To hold otherwise would appear to be an extreme example of loose statutory interpretation and an arbitrary disregard of statutory definitions.

D. The Effect of Application of Section 435(d)(1).

The result of having had three taxable years within the calendar year 1946 is that Section 435(d)(1) of the Internal Revenue Code must be applied to determine the excess profits tax net income of the Petitioner for each of the twelve months in that calendar year. Section 435(d) provides in part as follows:

> "(d) Average Base Period Net Income—General Average.—The average base period net income determined under this subsection shall be determined as follows:
>
> "(1) By computing the excess profits net income for each month in the base period. The excess profits net income for any month during any part of which the taxpayer was in existence shall be the excess profits net income for the taxable year in which such month falls divided by the number of full calendar months in such year, but in no case shall the excess profits net income for any month be less than zero. The excess profits net income for any month during no part of which the taxpayer was in existence shall be zero."

The application of this provision to the facts of this case is purely mathematical. The section clearly provides that the income of a taxable year is to be divided by the number of full months in such taxable year and that the result of that computation is the excess profits tax net income for each month during such year during any part of which the taxpayer was in existence. Applying this section to Petitioner's situation, there should first be divided by eight Petitioner's excess profits tax net income for the period January 1, 1946 through September 20, 1946. The result of this division is assigned to each month during any part of which the taxpayer was in existence during that period. Similarly, Petitioner's excess profits tax net income for the

taxable year September 21, 1946 through December 18, 1946 in the amount of \$78,512.90 should be divided by two and the result of that division should be assigned to each of the four months during which the taxpayer was in existence.

The result of these computations, as shown on page 7, may be summarized as follows:

1/1/46 to 8/31/46	9/1/46 to 9/30/46	10/1/46 to 11/31/46	12/1/46 to 12/31/46
\$68,174.60	\$ 8,521.83 39,256.45	\$78,512.90	\$32,124.84

The total for such twelve consecutive months is \$226,590.62.

The above computation has been categorized by The Tax Court of the United States as "unreasonable" because, so says The Tax Court, the Petitioner "has by this method expanded the 12 months of 1946 into 14 months and has computed excess profits net income for 'taxable years' rather than for months" (R. 37).

A simple answer to this contention is, first, that, as this Court will note from Exhibit 5-E, Column 5 thereof (R. 31), the Petitioner did not use two extra months but used only ten full months and four part months, following strictly the dictates of Section 435(d)(1). It would seem apparent that there were three taxable periods, one of which involved one fractional month, one of which involved two fractional months, and a third which involved one fractional month. Thus, there were four fractional months and ten full months, aggregating a period of twelve full months.

Secondly, the Petitioner has not made its computations for "taxable years" rather than for months, but, again as dictated by Section 435(d)(1), has computed its excess profits net income for each full month, and each fractional month, comprising each of its three "taxable years" in the calendar year 1946. The Petitioner does not wish to belabor the point, but it seems too clear for argument that Section

435(d)(1) requires that the computation be made in this manner.

E. The Principles of Statutory Construction Applicable to Tax Statutes Compel a Decision Upholding the Petitioner.

In the final analysis, the decision in this matter rests upon whether settled principles of statutory construction applicable to tax statutes are to be followed or whether by ignoring such principles settled rules are to be thrown into hopeless confusion. Is a taxpayer, already confused by the many vague and ambiguous sections of our Internal Revenue Code, to be told that he must ignore a clear statutory mandate, thereby having his confusion compounded, or is he to be upheld in faithfully following and applying such mandate? That is the principle involved in this matter.

There have been many decisions handed down by every level of our judicial system which afford clear and conclusive support to the importance of construing tax statutes as they are written by Congress. For example, in *United States v. Merriam*, 263 U.S. 179, 187-188 (1923), the Supreme Court of the United States, in language still quoted in this connection, stated:

> "On behalf of the Government it is urged that taxation is a practical matter and concerns itself with the substance of the thing upon which the tax is imposed rather than with legal forms or expressions. But in statutes levying taxes the literal meaning of the words employed is most important, for such statutes are not to be extended by implication beyond the clear import of the language used. If the words are doubtful, the doubt must be resolved against the Government and in favor of the taxpayer. *Gould v. Gould*, 245 U.S. 151, 153. The rule is stated by Lord Cairns in *Partington v. Attorney-General*, L.R., 4 H.L. 100, 122:

> " 'I am not at all sure that, in a case of this kind—a fiscal case—form is not amply sufficient; because, as I understand the principle of all fiscal legislation, it is this: If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown, seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be. In other words, if there be admissible in any statute, what is called an equitable construction, certainly such a construction is not admissible in a taxing statute, where you can simply adhere to the words of the statute.' And see *Eidman v. Martinez,* 184 U.S. 578, 583."

In *United States v. Olympic Radio & Television, Inc.,* 349 U.S. 232 (1955), the Supreme Court of the United States had to determine whether or not the phrase "paid or accrued" in Section 122(d)(6) of the Internal Revenue Code of 1939 was to be given the same meaning under that section as was provided in Section 48. The taxpayer, on the accrual basis, contended that in computing its net operating loss for carry-back purposes, it could deduct the amount of excess profits which were paid in that loss year but which had accrued in an earlier year. In holding against the taxpayer, the Supreme Court recognized that this would discriminate against an accrual basis taxpayer and favor a cash basis taxpayer. It insisted, however, on construing the language of the Internal Revenue Code as written, and stated, page 236:

> "The Court of Claims recognized the force of this analysis, but concluded that Congress could not have meant what it said because, if so, this particular carry-back provision would have little application. First, most corporations are on the accrual not the cash basis.

Second, if an accrual taxpayer is limited in its deductions to excess profits taxes accrued within the taxable year, the provision has little value since there is 'rarely a case when a taxpayer would be liable for any excess profits tax in a year in which it had sustained a net operating loss * * *.' 124 Ct. Cl., at 37, 108 F. Supp., at 111. This taxpayer argues the inequity of the results which would follow from our construction of the Code. But as we have said before, 'general equitable considerations' do not control the question of what deductions are permissible. *Deputy v. du Pont, supra,* at 493. It may be that Congress granted less than some thought or less than was originally intended. We can only take the Code as we find it and give it as great an internal symmetry and consistency as its words permit. We would not be faithful to the statutory scheme, as revealed by the words employed, if we gave 'paid or accrued' a different meaning for the purposes of § 122(d)(6) than it has in the other parts of the same chapter.

"Our construction is in harmony with the general rule that a taxpayer on an accrual basis must take deductions in the year of accrual. See *Security Mills Co. v. Commissioner,* 321 U.S. 281.

"The fact that the construction we feel compelled to make favors the taxpayer on the cash basis and discriminates against the taxpayer on the accrual basis may suggest that changes in the law are desirable. But if they are to be made, Congress must make them."

Demonstrating that an insistence upon a uniform construction of tax statutes cuts both ways, the Supreme Court of the United States, in*Lewyt Corporation v. Commissioner,* 349 U.S. 237 (1955), upheld a contention of a taxpayer that the excess profits taxes that could be offset against net income in a particular taxable year should be the amount of such taxes reported for that year rather than the amount of excess profits taxes ultimately found to be due. While this

resulted in the taxpayer, in effect, realizing a double benefit (since the amount ultimately found to be due was substantially less than the amount shown on its return), the Supreme Court stated, pp. 239-240:

> "The controversy turns on the meaning of the clause in § 122(d)(6) which reads, 'the amount of tax imposed by Subchapter E of Chapter 2 * * * accrued within the taxable year * * *.' The Commissioner contends that the tax 'imposed' is the tax ultimately determined to be due. The argument is that the taxpayer having once got back, through credit or refund, the difference between the amount of the tax 'accrued' in 1944 and the amount finally determined to be due, no double benefit should be inferred. The double benefit, it is argued, should certainly be denied when the figure upon which it is based has no economic reality.
>
> "But the rule that general equitable considerations do not control the measure of deductions or tax benefits cuts both ways. It is as applicable to the Government as to the taxpayer. Congress may be strict or lavish in its allowance of deductions or tax benefits. The formula it writes may be arbitrary and harsh in its applications. But where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer though they represent an unexpected windfall. See *Bullen v. Wisconsin,* 240 U.S. 625, 630."

The *Lewyt Corporation* case, *supra,* was cited by the Court of Appeals for the Tenth Circuit in *Diamond A Cattle Co. v. Commissioner,* 233 F.2d 739 (10th Cir. 1956), where it upheld the right of a corporate taxpayer to carry-back an artificially created loss realized by reason of the liquidation and transfer of all of its assets prior to the realization of income from its seasonal business of selling cattle. This loss was attributable to the portion of the year in which the taxpayer

operated. The taxpayer admitted that this loss factor was one of the reasons for liquidating at the time it did, but that the language of Sections 122(b)(1) and 710(c)(3)(A) of the 1939 Code (relating, respectively, to net operating loss carry-backs and excess profits credit) were clear and unambiguous. The Court of Appeals quoted from the *Lewyt Corporation* case, *supra*, with respect to the taxpayer receiving an unexpected windfall, and, in this connection, stated, page 742:

> "It is certainly true that this Petitioner has taken the maximum advantage of this situation taxwise, and this was probably a situation never contemplated by Congress * * * When Congress passes an Act in language that is clear and unambiguous and construed and read in itself can mean but one thing the Act must be judged by what Congress did and not by what it intended to do."

With respect to the action of The Tax Court in the instant case in choosing to ignore the clear provisions of Section 435(d)(1), the case of *Dravo Corp. v. United States*, 138 F. Supp. 274 (Ct. Cl. 1956), is particularly appropriate. Under Section 710(c)(3)(A) of the 1939 Code, it is provided that a taxpayer "shall" carry back any unused excess profits credit in determining its excess profits tax liability. By applying that section strictly, the total tax liability of the taxpayer in that case was substantially increased by reason of the fact that it lost the 10% postwar credit granted on excess profits taxes. It was clear that this credit was intended by Congress to be a relief provision, but the Respondent, of course, argued that the language of Section 710(c)(3)(A) had to be strictly applied.

The Court of Claims was sympathetic to the taxpayer, since it recognized that the application of such section would benefit all taxpayers except those in the situation of the

taxpayer. It stated that Congress, if aware of this particular situation, might have changed the section to permit an election by the taxpayer. The Court, however, felt obliged to sustain the Commissioner and enforce the specific terms of the statute, by stating, p. 276:

> "We cannot grant more relief than the application of the appropriate sections allow *without ignoring the plain language of Section 710(c)(3)(A).*" [Emphasis added.]

Finally, some mention should be made of the two cases cited by The Tax Court in its decision as authority for the proposition that the Petitioner's contention in this case is without merit. These two cases, *Church of the Holy Trinity v. United States,* 143 U.S. 457 (1892) and *United States v. American Trucking Associations, Inc.,* 310 U.S. 534 (1940), were not concerned, in the first place, with tax statutes. The first of these cases concerned a statute prohibiting the importation and migration of foreigners and aliens under a contract to perform labor. The Supreme Court, of course, held that this statute should not be applied to a contract between a religious society and an alien employed by it to be its minister of the gospel.

In the second of these cases, the Supreme Court was concerned with the construction of the Motor Carrier Act of 1935 and felt justified in limiting the meaning of the word "employees" used in that statute by reason of a rather voluminous legislative history showing that the intended scope of this word was to be so limited. It should be noted, however, that four of the nine justices dissented and adopted the opinion of the United States District Court as their opinion. *United States v. American Trucking Associations, Inc.,* 31 F. Supp. 35 (D.C. D.C. 1939). The language employed by the District Court on page 39, which was so adopted, is particularly appropriate to the situation found in this case:

> "In the view we take, the language of the disputed section is so plain as to permit only one interpretation, and we can find nothing in the Act as a whole which can with any assurance be said to lead to a different result. The circumstances under which the section was placed in the bill may possibly have created a situation not contemplated by its sponsors, but to say that this is true would be pure speculation, in which we have no right to indulge and upon which we can base no conclusion."

It is quite apparent that the circumstances in those two cases were quite different from the circumstances in the instant case. The answer to these cases can best be found in the following language of the Supreme Court of the United States in *Crooks v. Harrelson,* 282 U.S. 55, 59-60, 61 (1930), which is perhaps the most often quoted case for the proposition that tax statutes must be construed literally, and which refused to apply the principle of the *Holy Trinity Church* case:

> "It is urged, however, that if the literal meaning of the statute be as indicated above, that meaning should be rejected as leading to absurd results, and a construction adopted in harmony with what is thought to be the spirit and purpose of the act in order to give effect to the intent of Congress. The principle sought to be applied is that followed by this court in *Holy Trinity Church v. United States,* 143 U.S. 457; but a consideration of what is there said will disclose that the principle is to be applied to override the literal terms of a statute only under rare and exceptional circumstances. The illustrative cases cited in the opinion demonstrate that to justify a departure from the letter of the law upon that ground, the absurdity must be so gross as to shock the general moral or common sense. Compare *Pirie v. Chicago Title and Trust Company,* 182 U.S. 438, 451-452. And there must be something to make plain the intent of Congress that the

letter of the statute is not to prevail. *Treat v. White,* 181 U.S. 264, 268.

"Courts have sometimes exercised a high degree of ingenuity in the effort to find justification for wrenching from the words of a statute a meaning which literally they did not bear in order to escape consequences thought to be absurd or to entail great hardship. But an application of the principle so nearly approaches the boundary between the exercise of the judicial power and that of the legislative power as to call rather for great caution and circumspection in order to avoid usurpation of the latter. *Monson v. Chester,* 22 Pick. 385, 387. It is not enough merely that hard and objectionable or absurd consequences, which probably were not within the contemplation of the framers, are produced by an act of legislation. Laws enacted with good intention, when put to the test, frequently, and to the surprise of the law maker himself, turn out to be mischievous, absurd or otherwise objectionable. But in such case the remedy lies with the law making authority, and not with the courts. (Cases cited.)

* * * * * * *

"Finally, the fact must not be overlooked that we are here concerned with a taxing act, with regard to which the general rule requiring adherence to the letter applies with peculiar strictness."

The importance and necessity of construing tax statutes literally, whenever the words employed therein are not ambiguous or undefined, cannot be stated in clearer or more expressive terms than those quoted above from our highest courts. The Excess Profits Tax Act of 1950 has been described as the most technical taxing statute ever enacted, but that should not mean that its clearly worded, although technical, provisions and terms should be ignored in an obvious attempt to provide judicially what one may feel has been legislatively overlooked. Certainly the argu-

ment being made by the Petitioner in this case is not so absurd or "so gross as to shock the general moral or common sense."

V.

CONCLUSION

The basic issue in this case is simply a question of law, the solution of which is dictated by the following considered and sound conclusions:

A. Since it is clear that a taxpayer's excess profits net income for its base period necessitates a computation of such income for each month, and each fractional month, in such base period, the second sentence of Section 435(d)(1) of the Internal Revenue Code of 1939 must be applied in order to make such computation.

B. Because the term "taxable year", as contained in said Section 435(d)(1), so clearly means each period for which either a separate or consolidated return is filed, the Petitioner necessarily had three taxable years during the calendar year 1946.

C. The purely mathematical computation then required under Section 435(d)(1) clearly results, as demonstrated by Exhibit 5-E (herein set forth on page 7), in an excess profits net income for the twelve months of 1946 in the amount of $226,590.62.

D. The principles of statutory construction applicable to tax statutes require that Section 435(d)(1) not be ignored, that it be strictly applied to the facts as stipulated in this case, and that each and every term contained therein be given the meaning its plain language imports and as it has been defined.

For the foregoing reasons it is respectfully submitted that the decision of The Tax Court of the United States should be reversed and that the Respondent's determination

that there are deficiencies in the excess profits taxes of the Petitioner for the calendar years 1950, 1951 and 1952 be held to be in error.

Dated: San Francisco, California, March 19, 1958.

Respectfully submitted,

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